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No. 85-431 (3)

In the Supreme Court of the United States

OCTOBER TERM, 1985

HUMANA INC., ET AL., PETITIONERS

v.

MARGARET M. HECKLER,
SECRETARY OF HEALTH AND HUMAN SERVICES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

The Medicare Act, 42 U.S.C. 1395x(v)(I)(B), provides that proprietary providers of extended care services (*i.e.*, for-profit nursing homes) that participate in the Medicare program are entitled to be paid "a reasonable return on equity capital" at a rate that does not exceed a prescribed rate of return. The regulations of the Secretary of Health and Human Services extend this prescribed rate of return on equity capital to hospitals as well as nursing homes. 42 C.F.R. 405.429(a). The question presented is whether this method of compensating hospitals violates the general reimbursement provision of the Medicare Act, 42 U.S.C. 1395x(v)(1)(A), which states that providers are entitled to receive the "reasonable" costs, both direct and indirect, of providing necessary services to Medicare beneficiaries.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1A-22A) is reported at 758 F.2d 696. The opinion of the district court (Pet. App. 25A-36A) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 2, 1985 (Pet. App. 94A), and a petition for rehearing was denied on June 18, 1985 (Pet. App. 98A). The petition for a writ of certiorari was filed on September 14, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The portion of the Medicare program involved in this case, Part A, provides insurance for hospital and related post-hospital services. 42 U.S.C. 1395c, 1395d. Qualified

"providers of services" are reimbursed directly by the federal government for the costs of providing hospital and extended care to the Medicare Act's beneficiaries. Until October 1983, and as applicable to all claims for reimbursement involved in this case, the statute provided that providers treating Medicare beneficiaries were to be reimbursed under a retrospective, cost-based system. This system compensated the providers for the actual, reasonable costs incurred in providing Medicare services. 42 U.S.C. 1395f(b), 1395x(v)(1)(A). Congress did not specify a fixed formula for reimbursement, but rather authorized the Secretary of Health and Human Services to determine the method to be used in calculating such costs.

Statutory reimbursement for return on equity capital stands on a different footing. As originally enacted, the Medicare statute contained no provision concerning return on equity.[1] In 1966, Congress amended the Act to allow a return on equity capital for extended care services performed by proprietary providers (*i.e.*, for-profit nursing homes). Pub. L. No. 89-713, 80 Stat. 1107 *et seq*. Under this provision, the Secretary was directed to promulgate regulations to pay those providers a "reasonable return on equity capital * * * invested in the facility and used in the furnishing of * * * services" (42 U.S.C. 1395x(v)(1)(B)). The 1966 amendment provided that the rate of return was not to "exceed one and one-half times the average of the rates of interest, for each of the months any part of which is included in such fiscal period, on obligations issued for purchase by the Federal Hospital Insurance Trust Fund."

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[1]A regulation promulgated in 1966 authorized the recovery of an allowance amounting to 2% of otherwise allowable costs as reimbursement for items not specifically recognized, including return on equity. 20 C.F.R. 405.428 (1968). That regulation was rescinded in 1969. 34 Fed. Reg. 9927 (1969). See *Baylor University Medical Center* v. *Heckler*, 758 F.2d 1052 (5th Cir. 1985).

Ibid. As the legislative history indicates, Congress expected the Secretary to extend this allowance for return on equity not only to extended care facilities, but also to other proprietary hospitals. H.R. Conf. Rep. 2317, 89th Cong., 2d Sess. 3 (1966). In accordance with this congressional understanding, the Secretary promulgated regulations to allow all proprietary providers a reasonable return on equity capital. 20 C.F.R. 405.428 (1968) (31 Fed. Reg. 14816 (Nov. 22, 1966)).

In the 1983 amendments to the Social Security Act, Congress adopted a prospective payment system whereby providers are reimbursed not for actual costs, but instead at fixed pre-determined rates established for each category of patient services. Under this new system, capital costs, including return on equity, continue to be reimbursed as in the past, except that the 1983 amendments reduced the allowable rate for return on equity to providers for inpatient hospital services. 42 U.S.C. (Supp. I) 1395ww(g)(2).[2]

2. Petitioners, Humana Inc. and 64 of its subsidiary hospitals, brought this action challenging the denial by the Secretary of Health and Human Services of reimbursement for certain items claimed by petitioners as costs of their participation in the Medicare program. They raised numerous substantive and procedural challenges to the Secretary's denial of reimbursement for (1) stock maintenance costs, (2) income taxes and (3) stock acquisition costs. Petitioners also challenged the rate allowed by the Secretary for return on equity capital.

After the district court affirmed the Secretary's decisions on all issues raised by petitioners, the court of appeals affirmed in part and reversed in part. The court affirmed the

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[2]The allowance for return on equity for inpatient hospital services was reduced from one and one-half to one times the rate of interest paid by the Treasury on the assets of the Hospital Insurance Trust Fund. H.R. Conf. Rep. 98-47, 98th Cong., 1st Sess. 190 (1983).

disallowance of reimbursement for income taxes and the inclusion of income taxes in the calculation of return on equity capital as well as stock maintenance costs. The court, however, reversed the district court's holding "disallowing reimbursement for stock acquisition costs when an acquired corporation is liquidated or merged into the acquiring corporation" (Pet. App. 3A).[3]

As to the return on equity—the only issue raised in this Court—the court of appeals rejected petitioners' contention that "a proprietary hospital's return must be paid under 42 U.S.C. § 1395x(v)(1)(A) (1976), the 'reasonable costs' provision, rather than under 42 U.S.C. § 1395x(v)(1)(B) (1976), the subsection dealing with extended care facilities" (Pet. App. 13A). The court stated that its prior decision in *American Medical International, Inc.* v. *Secretary of Health, Education and Welfare (AMI)*, 677 F.2d 118 (D.C. Cir. 1981), aff'g 466 F. Supp. 605 (D.D.C. 1979), "precludes a finding that return on equity is payable under § 1395x(v)(1)(A), and since § 1395x(v)(1)(B) authorizes the Secretary to set a single, universal rate of return, we hold that Humana is not entitled to an individual determination of a 'reasonable' return on equity" (Pet. App. 14A).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with the decisions of this Court or of any other court of appeals. Further review by this Court is not warranted.

1. The issue in this case is not whether petitioners will be reimbursed for their return on equity capital, but how much they will be reimbursed. It is our submission that the Secretary's regulations provide a reasonable basis for payment

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[3]The government has not filed a petition for a writ of certiorari to challenge this determination.

that is consistent with Congress's intent. In contrast, petitioners contend (Pet. 16; Pet. App. 12A-13A) that the rate of return on equity capital paid by the Secretary "consistently fails to meet the true cost of attracting capital" and that rather than receiving a fixed allowance for return on equity capital, the cost of attracting private investment capital should be recognized as " 'costs' for which the corporation must be reimbursed" (Pet. 11). Thus, although petitioners do not expressly so state, they apparently contend, as they did below, that the amount of each hospital's allowance for return on equity capital must be evaluated on a "hospital-by-hospital basis" (Pet. App. 13A). Petitioners' contentions have no merit and ignore the basic structure and legislative history of the Medicare Act.

As the statutory background demonstrates (see pages 1-3, *supra*), from the inception of Congress's decision to recognize return on equity as an item of Medicare reimbursement, Congress has declined to treat it as a cost of providing necessary care to Medicare patients subject to reimbursement based on the expenses actually incurred (42 U.S.C. 1395x(v)(1)(A)). Rather, Congress established a separate statutory allowance, which "has its own independent basis in the Medicare Act." *Sun Towers, Inc.* v. *Heckler,* 725 F.2d 315, 335 (5th Cir. 1984), cert. denied, No. 83-1867 (Oct. 1, 1984).

2. In the face of this purposeful difference in treatment, petitioners contend (Pet. 13) that the legislative history of the Medicare Act supports their assertion that Congress intended to follow the "universal practice" of compensating private business, as an item of cost, for the reasonable return of investment capital they utilize for the convenience of the public. However, petitioners fail to mention that all courts of appeals that "have carefully examined the legislative history of the return on equity capital provision * * * have demonstrated persuasively that a return on equity is

not a 'reasonable cost' as contemplated by the Medicare Act." *Sun Towers* v. *Heckler*, 725 F.2d at 335; see *AMI, supra; St. Francis Hospital Center* v. *Heckler*, 714 F.2d 872, 874-875 (7th Cir. 1983), cert. denied, 465 U.S. 1022 (1984); *Hospital Authority* v. *Heckler*, 707 F.2d 456 (11th Cir. 1983).

Petitioners do not attempt to distinguish these decisions. Instead, petitioners recite a highly truncated version of the legislative history (Pet. 13-15). But the materials they cite (largely excerpts from the Senate Finance Committee Staff Report and Senate Finance Committee Hearings on the initial proposed regulations for Medicare reimbursement) indicate, at the very most, that Congress believed some allowance for return on equity was appropriate. Those excerpts do not show that Congress intended that return on equity—which is a "profit, not a cost" (*Sun Towers* v. *Heckler*, 725 F.2d at 335)—be reimbursed on the same basis as other costs of providing care to Medicare patients.[4]

Moreover, petitioners are simply wrong in asserting that the legislative history shows that Congress intended that the 1966 amendment to the Medicare Act, which established a rate of return on equity capital for extended care facilities, should not apply to proprietary hospitals. When Congress enacted this amendment, it expressly stated its expectation that "the Secretary * * * will apply similar or comparable principles in determining reasonable costs for reimbursement of proprietary hospitals for services furnished by

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[4]In fact, the courts have concluded that "the exchanges between senators and administrators at the Hearing [on the proposed regulations] 'make it quite unequivocal that the Senate Committee members believed that a return on equity capital was not, and should not, be provided [by the Medicare Act].' " *Hospital Authority* v. *Heckler*, 707 F.2d at 458, quoting district court opinion, 522 F. Supp. at 572. See also *St. Francis Hospital Center* v. *Heckler*, 714 F.2d at 880-881, adopting district court opinion (544 F. Supp. 1167, 1181 (S.D. Ind. 1982)).

them." H.R. Conf. Rep. 2317, *supra,* at 3.[5] Of course, this is exactly what the Secretary did. 31 Fed. Reg. 14816 (1966). The Secretary has continued to treat return on equity as an independent allowance (42 C.F.R. 405.429 (1984)), not as a cost of operation, and Congress, which has amended the statute several times and left the allowance intact, has in substance ratified this practice. Indeed, as recently as 1983, when Congress revamped the Medicare reimbursement scheme by replacing the concept of reimbursement based on actual costs with a Prospective Payment System, it again left unchanged the separate treatment for return on equity. 42 U.S.C. (Supp. I) 1395ww(g)(2).

Thus, the court of appeals correctly concluded (Pet. App. 14A (citation omitted)) that return on equity is an "exception to the basic Medicare principle that reimbursement be limited to those costs actually incurred in providing patient care services." Since this interpretation is consistent with the decisions of all other courts of appeals that have addressed this issue, review by this Court is plainly unwarranted.[6]

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[5]In commenting on a Senate proposal that led to this amendment, Senator Long, Chairman of the Senate Finance Committee, viewed the provision for a return on equity as an allowance for profit and as an exception to the Medicare Act's specific reimbursement for reasonable costs. He stated (112 Cong. Rec. 27608 (1966)):

> What we sought was to guarantee to the individual who invested his funds in a facility organized for profit that he would receive a fair return on the money he had put into the operation. As the proposed medicare regulations stood he would have been only reimbursed for the actual costs of providing services with no specific return given on his investment.

[6]The court of appeals also was correct in rejecting petitioners' reliance on cases that held government-prescribed rates to be confiscatory and therefore violative of the Fifth Amendment prohibition on the taking of property without just compensation (Pet. App. 10A-11A). If a health care provider considers the rate of allowance for return on equity to be insufficient, the simple answer is that it does not have to participate in

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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the Medicare program, for participation is entirely voluntary. *St. Francis Hospital Center* v. *Heckler*, 714 F.2d at 875 ("[p]roviders who opt not to participate are free to serve persons not covered by Medicare and those potential Medicare recipients who are willing to forego Medicare benefits for the services provided"). Such a provider may then charge whatever rates its business judgment advises, a situation altogether unlike the cases upon which petitioners rely (Pet. 11-12). Those cases involved ratemaking in the utility industry where, as the court of appeals noted (Pet. App. 11A), "utilities are forced to operate within a tightly regulated scheme if they are to operate at all." In any event, this Court denied certiorari on virtually the same issue in *St. Francis Hospital Center*, and the same result should obtain here.

*The Solicitor General is disqualified in this case.

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